

Groover Companies, Inc.

4200 Dundee Road, Winter Haven Florida 33884

Office Phone (863) 324-6083

Fax (863) 324-0426

Website – www.GrooverAppraisal.Net

Email – Desi@groover-co.net

Real Estate Appraisers and Consultants

J Desi Groover, St. Cert. Gen. REA RZ1313

Mark McCurdy, St. Cert. Gen. REA RZ2906

Debbie Groover, Reg. Trainee Appraiser RI8112

Carolyn Cabanas, Reg. Trainee Appraiser RI20888

Allison M Gibson, Reg. Trainee Appraiser RI19866

Eric Pospichal, Reg. Trainee Appraiser RI22684

Brian Smith, Reg. Trainee Appraiser RI22482

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What if?

Lets suppose Mr. Ben Bernanke and his crew are lot smarter than many people think.

Until recently, I thought the people at the Federal Reserve had lost their minds. I recently had some friends over to dinner, and for some reason the topic of the Fed reducing the reserve rate was broached. I believe I commented on a question that came to my mind; which was why would the Fed continue to lower the reserve rate when they knew that without a doubt it would fuel inflation? That even a dumb redneck from Polk County Florida could understand this. It simply made no sense; yes it became a puzzlement that needed an answer. So I entered into the self-imposed challenge to understand what is happening.

In the process, I questioned – what if the fed was looking at inflation not as a foe, but as a friend.

The sub-prime lending debacle resulted in nearly 2.5% of mortgages nationally being foreclosed or in trouble in recent days, and potentially many more to come. The problem is that sale prices for many residential homes spiked during 2004 to 2006, and loans were made during this period on some really high values. When the values declined, banks and property owners were left with an abundance of loans and properties that could not be resold at a price that would satisfy the original loan amount. As such, the owners would have to hold the property for years until the market caught up with the prices they paid for their home, the owners would give the house back to the bank and the bank would have to write down the loan, or foreclosure, or a bunch of really bad scenarios. How can we overcome such a devastating blow to our economy, and the banking system?

What if the plan is to cause the value of a dollar to decline against other currencies and allow (no force) the US to experience a period of inflation similar to the spike in real estate values? If the economy can be carefully balanced with high inflation and an effective method to stimulate market activity, then the divide between current housing prices and the prices paid in 2005 & 2006 could be substantially narrowed. If the difference in values is narrowed or better yet negated the sub-prime loan problem goes away. The Fed then increases the reserve requirement, the value of the dollar increases, inflation decreases (gas prices begin to decline as oil can now be purchased with fewer dollars), and we are back to an economy reminiscent of the good years between 2000 and 2004. It is true that we will be experiencing much higher prices for houses, goods and services; however, we are no longer limited by the gold standard, so the treasury can just print some extra money over time to ease the affect of the inflation. Ultimately, the Fed has dramatically reduced the time needed to overcome the sub-prime lending crisis, possibly reducing the recovery time from 12 to 16 year to a period of maybe 2 to 3 more years.

Yes this is all speculation, but what if this really is the plan? While there is definitely a downside to such a plan, I believe it will work!

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Tell me what you think?